INTERSTATE STORES, INC. ANNUAL REPORT 1971

Financial Highlights (In thousands)

	[1971]	[1970]
Total sales	$708,433	$684,696
Earnings before extraordinary item and federal taxes	773	2,713
Earnings before extraordinary item	568	1,373
Extraordinary item, net of taxes	895	—
Net earnings	1,463	1,373
Per share information:		
Earnings before extraordinary item*	.11	.25
Extraordinary item*	.16	—
Net earnings*	.27	.25
Dividends	—	.45
Current ratio	1.5 to 1	1.5 to 1
Working capital	$ 52,419	$ 55,272
Total assets	286,223	287,163
Mortgages payable	26,828	30,771
Other long-term debt	39,597	41,107
Stockholders equity	98,718	97,171

*Based on average number of shares for each year.

INTERSTATE STORES, INC.
ANNUAL REPORT 1971

Directors	Sam J. Abend Sol W. Cantor Walter Craig Seymour B. Ginsburg Samuel Hausman Charles Lazarus M. Lester Mendell Albert Parker Paul D. Preger Edward C. Schenkel Harold J. Szold Robert C. Van Tuyl
Officers	Sol W. Cantor Chairman
	Charles Lazarus Senior Vice President
	Sam J. Abend Vice President
	Richard Chalifoux Vice President
	Walter Craig Vice President
	Daniel L. Reit Vice President
	Edward C. Schenkel Vice President and Treasurer
	Albert Parker Secretary
	Solomon Fisher Assistant Secretary
	Norman Ricken Assistant Secretary
Transfer Agent	Bankers Trust Company New York, New York
Registrar	Manufacturers Hanover Trust Co. New York, New York
General Counsel	Parker, Chapin and Flattau New York, New York
Auditors	S. D. Leidesdorf & Co. New York, New York
Executive Offices	111 Eighth Avenue New York, New York 10011
	Annual Meeting is held the Fourth Wednesday in May Shares listed New York Stock Exchange—ISD

To Our Shareowners:

Sales of Interstate Stores, Inc., in the fiscal year that ended January 30, 1972, increased to $708 million from $685 million the prior year. It was the 14th consecutive year in which sales surpassed any previous year.

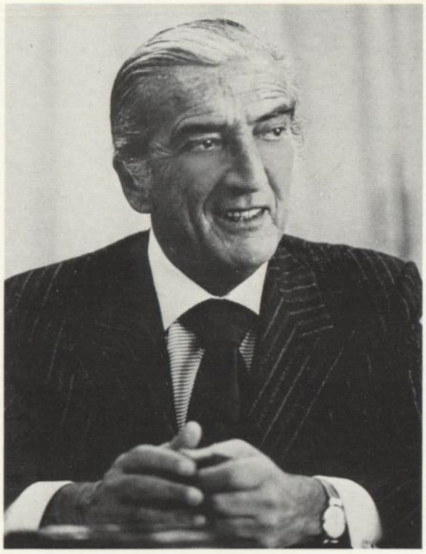
Net earnings totalled $1.5 million, equal to $.27 a share. In the prior year, the Company earned $1.4 million, equal to $.25 a share.

Earnings included a non-recurring gain of $895,000, net of applicable federal and state taxes, which was realized in the first quarter and reported at that time. The gain resulted from the sale of an option to purchase a minority interest in a chain of discount gasoline service stations operated at the Company's West Coast stores.

Earnings in the fourth quarter showed improvement over the comparable period last year and enabled the Company to offset the loss for the nine months. In this quarter Interstate earned $5,163,000, equal to $.95 a share, which compares with earnings of $3,814,000, or $.70 a share in the final quarter of the prior year.

Our balance sheet continued strong. Inventories declined to $121.2 million from $126.1 million, even with an increase in the number of stores. Accounts payable declined by $16.6 million. The ratio of current assets to current liabilities was 1.5 to 1, the same as at the end of the prior year. Stockholders' equity rose to a high of $98.7 million, which compares with $97.2 million a year ago.

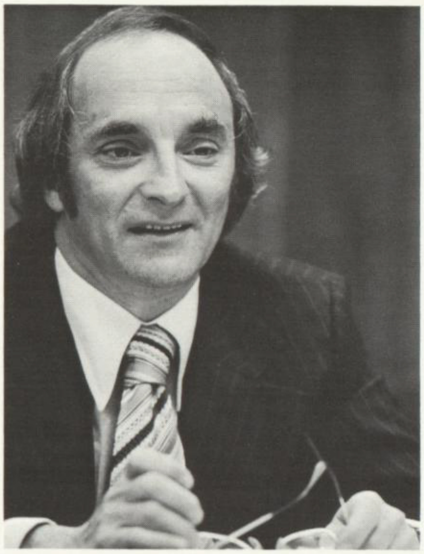
Important steps were undertaken last year to renew and strengthen the profitability of the Company's operations. These included: discontinuance of a group of unprofitable stores in the discount field, restructuring of our discount store organization, continuation of our expansion in the toy retail field, and realigning our management organization and systems.



Chairman of the Board Sol W. Cantor re-assumed responsibility as chief executive officer of the Company.

In line with its objective of terminating marginal store operations, five discount stores, located in the Philadelphia and Columbus areas, were discontinued during the year, with no loss to the Company. The remaining group of marginal stores, estimated at 15, will be discontinued over the next few years.

As part of this program, we intend to make the necessary investment of effort and funds to strengthen the competitive position of the rest of our discount chain. Primary emphasis is being placed on stores that are "clustered" around major market areas, each of which will gain from the further implementation of coordinated and aggressive marketing programs.



Senior Vice President Charles Lazarus was given responsibility for the consolidated toy operations.

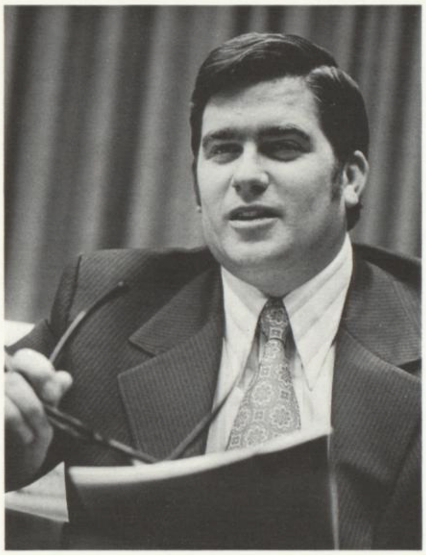
Our expansion continued last year, with emphasis shifted from discount stores to toy operations. We opened 9 new toy stores, as compared with a net reduction of 2 units in the discount store chain. We now have 37 toy stores that are contributing on an annualized basis more than $100 million to sales and are producing satisfactory profits. The objective over the next few years is to try to double sales and earnings in this division.

The toy operations, Toys-R-Us and Children's Bargaintown, heretofore operated as separate divisions, are being consolidated. Steps were taken towards the latter part of the year to bring this about. We believe the growth objectives in the toy field can best be accomplished with a unified management and a single identity, Toys-R-Us. New stores will be opened under this name, and where feasible this identity will be applied to existing toy stores.

The closing of marginal discount stores should release between $20 and $25 million in assets over the next few years, much of which will be reinvested in the expansion program.

Our conventional department store division, which numbers 31 suburban and downtown department stores, continued to show improvement. Progress has been steady since we started the program fourteen years ago of revitalizing these stores. Today, with two-thirds the conventional department stores operated then, sales and earnings are substantially greater.

A major key to the success of our program for renewing Interstate's profitability is management. We are seeking to develop the aggressiveness that characterized the Company's growth between 1959 and 1968. A number of important organizational changes have been made. All of our discount operations have been placed under the direction of Walter Craig, who was previously in charge of the White Front Division, and is now responsible for the Topps Division as well. In March of this year he was elected a member of the Board of Directors.



Vice President Walter Craig was placed in charge of all of Interstate Store's discount operations.

Charles Lazarus, who founded Toys-R-Us, was placed in charge of our consolidated toy operations early this year. Last year he was elected senior vice president of the Company and a member of the Board.

In the fall of the year, I assumed the responsibilities once again of chief operating officer of the Company.

We are confident that Interstate has all the resources required to get it moving forward. It has the people, the funds and the experience. The last quarter of the year showed progress over the same period last year. It was the first quarter since 1968 to show an improvement in earnings over the comparable period the year before. We expect this progress to continue, although signs of it will not be readily evident in the first half because of the losses normally incurred in this period.

The rate of improvement will depend to some extent on the continued recovery of the nation's economy and the success of efforts to reduce unemployment which continues at a high rate in many of our primary market areas.

Sincerely,

Sol W. Cantor
Chairman

Ten Year Financial Review

Operations	1971	1970
Total Sales	$708,433,000	$684,696,000
Discount Store Sales (Including Toys)	632,323,000	613,540,000
Conventional Department Store Sales	76,110,000	71,156,000
Earnings before Taxes and Extraordinary Item	773,000	2,713,000
Earnings before Extraordinary Item	568,000	1,373,000
Extraordinary Item—Net of Taxes	895,000	—
Net Earnings	1,463,000	1,373,000
Earnings Per Share*	.27	.25
Earnings Per Share:		
Before Extraordinary Item*	.11	.25
Extraordinary Item*	.16	—
Financial		
Working Capital	$ 52,419,000	$ 55,272,000
Current Ratio	1.5 to 1	1.5 to 1
Total Assets	286,223,000	287,163,000
Fixed Assets	96,257,000	97,485,000
Mortgages Payable	26,828,000	30,771,000
Other Long Term Debt	39,597,000	41,107,000
Stockholders' Equity	98,718,000	97,171,000
Dividends		
Cash, Per Share	—	.45
Stock Dividends	—	—
Stock Splits	—	—
Stores		
Discount	107	109
Conventional	31	30
Toys	37	28
Total	175	167

1969	1968	1967	1966	1965	1964	1963	1962
$656,550,000	$589,355,000	$506,969,000	$460,535,000	$398,207,000	$358,231,000	$296,224,000	$219,614,000
581,280,000	517,813,000	442,486,000	399,741,000	342,002,000	304,055,000	241,446,000	164,288,000
75,270,000	71,542,000	64,483,000	60,794,000	56,205,000	54,176,000	54,778,000	55,326,000
17,100,000	21,981,000	17,797,000	17,340,000	14,433,000	11,122,000	7,122,000	5,249,000
8,800,000	10,981,000	10,197,000	9,790,000	7,933,000	5,922,000	3,907,000	2,909,000
—	—	—	—	—	—	—	—
8,800,000	10,981,000	10,197,000	9,790,000	7,933,000	5,922,000	3,907,000	2,909,000
1.70	2.27	2.16	2.13	1.79	1.41	1.05	.79
1.70	2.27	2.16	2.13	1.79	1.41	1.05	.79
—	—	—	—	—	—	—	—
$ 50,673,000	$ 55,290,000	$ 57,142,000	$ 37,641,000	$ 38,769,000	$ 37,618,000	$ 28,178,000	$ 14,786,000
1.5 to 1	1.8 to 1	1.9 to 1	1.6 to 1	1.9 to 1	2.1 to 1	2.1 to 1	1.5 to 1
263,057,000	195,593,000	165,610,000	133,015,000	108,366,000	91,287,000	68,610,000	59,670,000
78,427,000	55,847,000	37,228,000	27,380,000	19,158,000	12,925,000	9,557,000	9,780,000
21,159,000	12,155,000	4,713,000	2,939,000	1,292,000	380,000	250,000	280,000
28,813,000	29,991,000	30,019,000	10,620,000	12,500,000	15,200,000	15,369,000	5,682,000
98,301,000	76,031,000	66,706,000	57,843,000	48,648,000	40,639,000	26,363,000	23,218,000
.60	.60	.48	.46	.39	.30	.22	.17
—	—	—	4%	4%	4%	4%	4%
—	—	5-for-4	—	—	2-for-1	—	—
97	86	75	66	59	58	51	44
31	31	32	31	31	32	34	36
21	8	6	4	—	—	—	—
149	125	113	101	90	90	85	80

*Based on average number of shares for each year, adjusted to give effect to all stock dividends and stock splits.

Consolidated Balance Sheets

Interstate Stores, Inc.
and Subsidiary Companies

	1971 (Jan. 30, 1972)	1970* (Jan. 31, 1971)
Assets		
Current Assets:		
Cash	$ 15,921,000	$ 9,956,000
Short-term investments—at cost (approximates market)	500,000	1,010,000
Accounts receivable:		
Customers (net of allowances of $431,000 and $488,000, respectively)	10,891,000	11,161,000
Other (Note D)	10,037,000	9,863,000
Merchandise inventories (at the lower of cost or market, determined principally by the retail method)	121,190,000	126,082,000
Fixed assets held for sale	211,000	1,866,000
Prepaid expenses	3,377,000	3,081,000
Total Current Assets	162,127,000	163,019,000
Other Assets (Note D)	7,591,000	5,895,000
Fixed Assets—at cost (Note B):		
Land and buildings	36,559,000	38,679,000
Furniture and equipment	60,544,000	55,964,000
Leaseholds and leasehold improvements	27,542,000	25,159,000
	124,645,000	119,802,000
Less: Accumulated depreciation and amortization	28,388,000	22,317,000
	96,257,000	97,485,000
Deferred Charges	2,121,000	2,496,000
Intangibles Applicable to Subsidiaries Acquired	18,127,000	18,268,000
	$286,223,000	$287,163,000

*Reclassified.
See accompanying notes to financial statements.

	1971 (Jan. 30, 1972)	1970* (Jan. 31, 1971)
Liabilities		
Current Liabilities:		
Notes payable—banks (Note J)	$ 17,000,000	
Current installments of long-term debt (Note B)	2,088,000	$ 1,219,000
Mortgage applicable to fixed assets held for sale		615,000
Accounts payable—trade	67,447,000	84,034,000
Accrued expenses and other liabilities	14,973,000	15,599,000
Taxes withheld and accrued, other than Federal income taxes	6,817,000	5,398,000
Accrued Federal income taxes	1,383,000	882,000
Total Current Liabilities	109,708,000	107,747,000
Long-term Debt (Note B):		
Mortgages	26,828,000	30,771,000
Debentures, notes and other	39,597,000	41,107,000
	66,425,000	71,878,000
Deferred Items (including Federal income taxes of $7,563,000 and $7,128,000, respectively) (Note G)	11,372,000	10,367,000
	187,505,000	189,992,000
Stockholders' Equity (Notes B, C and F):		
Common Stock (stated at par value of $1 per share, plus $1,271,000 retained as Capital by resolution of the Board of Directors):		

Shares	1971	1970
Authorized	10,000,000	10,000,000
Issued	5,473,456	5,465,588

	1971 (Jan. 30, 1972)	1970* (Jan. 31, 1971)
Common Stock (Issued)	6,745,000	6,737,000
Capital Surplus	48,796,000	48,721,000
Retained Earnings	43,201,000	41,738,000
	98,742,000	97,196,000
Less: Treasury Stock—at cost—5,800 and 6,000 shares, respectively	24,000	25,000
	98,718,000	97,171,000
Commitments, Contingencies and Other Comments (Notes D, E and H)		
	$286,223,000	$287,163,000

*Reclassified.
See accompanying notes to financial statements.

Consolidated Statements of Earnings and Retained Earnings

Interstate Stores, Inc.
and Subsidiary Companies

	1971 (Year Ended Jan. 30, 1972)	1970* (Year Ended Jan. 31, 1971)
Sales and Other Income:		
Net Sales:		
Owned departments	$595,996,000	$572,605,000
Leased departments	112,437,000	112,091,000
	708,433,000	684,696,000
Other Income—Net	1,359,000	2,988,000
	709,792,000	687,684,000
Costs and Expenses:		
Cost of Sales (including certain buying, occupancy and distribution expenses)	550,187,000	532,817,000
Selling, General and Administrative Expenses	144,669,000	140,237,000
Depreciation and Amortization (computed on the straight-line method)	7,236,000	6,187,000
Interest—Mortgages	2,315,000	1,740,000
Interest—Other	4,612,000	3,990,000
	709,019,000	684,971,000
Earnings before items shown below	773,000	2,713,000
Provision for Federal Income Taxes (Note G):		
Current	(230,000)	(490,000)
Deferred	435,000	1,830,000
	205,000	1,340,000
Earnings before extraordinary item	568,000	1,373,000
Extraordinary item—gain on disposition of an option, net of taxes of $805,000	895,000	
Net Earnings	1,463,000	1,373,000
Retained Earnings—at beginning of year	41,738,000	42,821,000
	43,201,000	44,194,000
Cash Dividends Declared		2,456,000
Retained Earnings—at end of year (Note B)	$ 43,201,000	$ 41,738,000
Net earnings per share of Common Stock (Note I):		
Earnings before extraordinary item	$.11	$.25
Extraordinary item	.16	
Net earnings	$.27	$.25

*Reclassified.
See accompanying notes to financial statements.

Consolidated Statements of Changes in Financial Position

Interstate Stores, Inc.
and Subsidiary Companies

	1971 (Year Ended Jan. 30, 1972)	1970* (Year Ended Jan. 31, 1971)
Source of Funds:		
From operations:		
Earnings before extraordinary item	$ 568,000	$ 1,373,000
Add—Items not requiring current outlay of funds:		
Depreciation and amortization of fixed assets	7,236,000	6,187,000
Deferred Federal income taxes	435,000	1,830,000
Amortization of store pre-opening expenses	2,112,000	2,616,000
Other—Net	14,000	277,000
Funds provided from operations, exclusive of extraordinary item	10,365,000	12,283,000
Extraordinary item, net of taxes of $805,000	895,000	
Less—Asset received not providing funds in the current period	1,371,000	
	(476,000)	
Funds provided from operations	9,889,000	12,283,000
Increase in long-term debt:		
Mortgages	1,250,000	12,478,000
Other long-term debt (before deducting $32,000 and $226,000, respectively, net of related expenses, of Debentures converted into Common Stock)		13,282,000
Increase in deferred items	57,000	87,000
Exercise of employee stock options	48,000	49,000
Sale of fixed assets (including $211,000 and $1,866,000, respectively, of fixed assets held for sale included in current assets), net of mortgages thereon of $3,487,000 and $1,177,000, respectively	2,851,000	5,371,000
Decrease in other assets	423,000	
Decrease in intangibles	141,000	114,000
	14,659,000	43,664,000
Application of Funds:		
Fixed assets acquired:		
Land and buildings	1,852,000	12,105,000
Other fixed assets	10,827,000	18,797,000
Cash dividends		2,456,000
Increase in other assets		238,000
Store pre-opening expenses	1,332,000	2,841,000
Increase in deferred charges	317,000	177,000
Repayments and current maturities of long-term debt	3,184,000	2,451,000
	17,512,000	39,065,000
Increase/(decrease) in working capital	($2,853,000)	$ 4,599,000
Increase/(decrease) in working capital by element:		
Cash	$5,965,000	($90,000)
Short-term investments—at cost	(510,000)	(285,000)
Accounts receivable:		
Customers, net	(270,000)	(816,000)
Other	174,000	(1,016,000)
Merchandise inventories	(4,892,000)	4,853,000
Fixed assets held for sale	(1,655,000)	1,866,000
Prepaid expenses	296,000	285,000
Notes payable—banks	(17,000,000)	6,169,000
Current installments of long-term debt	(869,000)	(68,000)
Mortgage applicable to fixed assets held for sale	615,000	(615,000)
Accounts payable—trade	16,587,000	(12,178,000)
Accrued expenses and other liabilities	626,000	4,109,000
Taxes withheld and accrued, other than Federal income taxes	(1,419,000)	(751,000)
Accrued Federal income taxes	(501,000)	3,136,000
Increase/(decrease) in working capital	($2,853,000)	$ 4,599,000

*Reclassified.
See accompanying notes to financial statements.

Notes to Financial Statements

Note A—The consolidated financial statements include the accounts of the Company, all subsidiaries and all majority-owned joint ventures. See Note D with respect to 50% owned corporations and joint ventures not consolidated.

Note B—Long-term debt consists of:

	1971	1970
5⅜% Notes—insurance companies	$ 6,500,000	$ 7,250,000
4⅝% Convertible Subordinated Debentures due August 1, 1981	453,000	485,000
4% Convertible Subordinated Debentures due August 1, 1992	20,000,000	20,000,000
Mortgages	28,211,000	31,478,000
Renewable notes	13,000,000	13,000,000
Other	349,000	884,000
	68,513,000	73,097,000
Less current installments	2,088,000	1,219,000
	$66,425,000	$71,878,000

The 5⅜% Notes are payable $500,000 a year through 1976, $600,000 a year from 1977 through 1982 and $900,000 in 1983.

The indentures applicable to the 4⅝% and 4% Debentures require annual redemptions of $275,000 and $900,000, respectively, aggregating $275,000 through 1977, $1,175,000 from 1978 to 1980, and $900,000 from 1981 to 1991. Each Debenture's annual redemption requirement is subject to reduction, at the Company's option, for prior conversions which aggregate $5,407,000 (applicable solely to the 4⅝% Debentures) as at January 30, 1972. It is the Company's present intention to exercise this option. The 4⅝% and 4% Debentures may be converted into Common Stock at conversion prices of $9.40 and $43.89 a share, respectively. During the years ended January 30, 1972 and January 31, 1971, $32,000 and $231,000 of 4⅝% Debentures were converted into 3,453 and 24,527 shares of Common Stock, resulting in increases in Common Stock of $4,000 and $25,000 and in Capital Surplus of $28,000 and $201,000. Based upon the foregoing conversion prices, the outstanding Debentures as at January 30, 1972 are convertible into 503,823 shares of Common Stock.

In November 1970, the Company borrowed $13,000,000, evidenced by six-month notes, renewable at its option. The interest rate (presently 7½%) is reestablished at each renewal date at 1¼% over first class bank rates for six-month U.S. dollar deposits in the Eurodollar market. The maximum amount of the loan ($13,000,000) is to be reduced by 25% in 1973 and 25% in 1974 and the balance of the loan is due in 1975. It is the Company's present intention to continually renew the notes under the terms of the agreement and, accordingly, the loan has been classified as long-term debt at January 30, 1972.

Formulae contained in certain of the loan agreements limit the aggregate amount available for cash dividends to approximately $18,500,000 as at January 30, 1972.

The mortgages (1) bear interest at annual rates of 4½% to 11%, (2) are payable in varying installments with final payments becoming due in 1973-2002 and (3) are collateralized by fixed assets having a depreciated cost of approximately $32,000,000.

See Note D as to long-term debt (not included herein) of 50% owned corporations and joint ventures.

Note C—Under the Company's stock option plans, options for 44,450 shares may be granted to 1973 and for 78,950 shares to 1978, at not less than the fair market values at dates of grant. Depending on the plan, options are either exercisable 25% a year (on a cumulative basis) commencing one year from date of grant or are exercisable in full after four years and nine months from date of grant. Options expire five years from date of grant. Changes in shares subject to outstanding stock options are as follows:

	1971	1970
Outstanding beginning of year	168,048	158,160
Granted	74,300	97,200
Lapsed	(29,533)	(29,688)
Cancelled	(22,500)	(54,200)
Exercised	(4,415)	(3,424)
Outstanding end of year ($13.67 to $45.38 a share — 1971)	185,900	168,048
Exercisable at end of year..	22,099	22,530

The options exercised resulted in credits to Common Stock of $4,000 (1971) and $3,000 (1970) and Capital Surplus of $44,000 (1971) and $46,000 (1970).

Note D—Subsidiaries of the Company have 50% interests in a number of corporations and joint ventures, whose functions are to acquire properties, construct store buildings thereon and lease all or substantial portions thereof to other subsidiaries. The investments in (carried at proportionate share of underlying equity) and advances to these companies aggregated $2,900,000 and $2,456,000 as at January 30, 1972 and January 31, 1971, respectively. Of these amounts, $87,000 (1971) and $512,000 (1970) are included in Accounts Receivable—Other and $2,813,000 (1971) and $1,944,000 (1970) are included in Other Assets. The subsidiaries' share of net income/(loss) of these entities included in Other Income—Net aggregated $197,000—1971 and ($17,000) —1970.

As at their respective fiscal year-end dates (December 31 or January 31) net fixed assets and long-term debt of the above 50% owned entities, not included in the Consolidated Balance Sheets, were as follows:

	1971	1970
Net fixed assets .	$63,416,000	$73,440,000
Long-term debt ..	$57,114,000	$65,122,000

As at January 30, 1972, subsidiaries of the Company were contingently liable as to $2,044,000 of the above long-term debt. The obligations bear interest at annual rates of 5¼% to 10¼% and are payable in varying installments with final payments becoming due in 1986-2002. In addition the Company and certain subsidiaries had guaranteed bank indebtedness of some of the 50% owned companies aggregating $2,448,000 at January 30, 1972. It is anticipated that this indebtedness will be refinanced on a long-term basis not subject to such guarantee. Data included in this paragraph are based upon unaudited financial statements.

The consolidated statements of earnings include amounts received from and paid to some of the 50% owned companies and joint ventures, as follows: income representing fixed annual amounts and/or amounts equivalent to cash flow from real estate (as defined in certain joint venture agreements) of $530,000 (1971) and $291,000 (1970), interest income of $8,000 (1971) and $362,000 (1970) and rentals paid of $6,307,000 (1971) and $5,915,000 (1970).

Note E—Minimum annual rentals of real and personal property leased to the Company or to its subsidiaries amount to approximately $21,000,000 (including $6,600,000 under leases with 50% owned corporations and joint ventures referred to in Note D) plus, in certain instances, additional rentals based upon sales and charges for real estate taxes, insurance, etc. Of the aggregate annual rentals, $5,900,000 expires prior to 1986, $6,400,000 expires between 1986 and 1991, and $8,700,000 expires after 1991.

At January 30, 1972, the Company and certain subsidiaries were contingently liable for approximately $2,800,000 relating to certain of their landlords' obligations; such contingent liabilities are subject to reduction to the extent that required payments are made by the landlords against such obligations.

Note F—During the year ended January 30, 1972, 200 shares of Treasury Stock were issued to an employee as a bonus. This transaction resulted in credits to Treasury Stock of $1,000 and to Capital Surplus of $3,000.

During the year ended January 31, 1971, 6,000 shares of Common Stock issued to an employee in a prior year were retransferred to the Company pursuant to an amendment to his employment contract. This transaction resulted in charges to Treasury Stock of $25,000 and to Capital Surplus of $297,000.

See Notes B and C for other stock issued.

Note G—Deferred Federal income taxes result principally from the excess of depreciation and amortization used for income tax purposes over amounts used for financial reporting purposes.

Investment tax credits are applied as a reduction of the provision for Federal income taxes. Such credits amounted to $240,000 (including $45,000 carried forward from prior years) for the year ended January 30, 1972.

Note H—The Internal Revenue Service has proposed deficiencies in income taxes against the Company and its subsidiaries for the seven years ended January 31, 1968. The proposed assessments, if sustained in their entirety, would result in additional

taxes of approximately $3,800,000 (net of an $800,000 duplication in the proposed assessment applicable to certain subsidiaries) exclusive of interest. The major portion of the proposed assessment involves constructive dividends purportedly received by the Company from its subsidiaries. Should the Internal Revenue Service attempt to apply the same theory to the year ended February 2, 1969, the Company could be subject to an additional deficiency of $950,000. Commencing with the year ended January 31, 1970, the companies filed consolidated tax returns and the issue as to constructive dividends would no longer be applicable.

The Company considers the proposed assessments improper; the Company has already filed formal protests with respect thereto and firmly believes that the ultimate disposition of this tax matter would have no material adverse effect upon the accompanying financial statements. Accordingly, no provisions for Federal income taxes or related interest have been made for the foregoing.

Note I—Earnings per share have been computed in accordance with Opinion 15 of the Accounting Principles Board of the American Institute of Certified Public Accountants. The assumed conversion of Debentures and exercise of Stock Options would not result in a dilution of net earnings per share.

Note J—Subsequent to January 30, 1972 (through April 17, 1972), the Company and certain subsidiaries borrowed an aggregate of $14,500,000 on a short-term basis. At April 17, 1972 and April 19, 1971, total short-term borrowings were $31,500,000 and $39,000,000, respectively.

Accountants' Report

To the Board of Directors
Interstate Stores, Inc.
New York, N.Y.

We have examined the consolidated balance sheets of Interstate Stores, Inc., and subsidiary companies as at January 30, 1972 and January 31, 1971, and the related consolidated statements of earnings and retained earnings and changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, subject to the outcome of the tax matter referred to in Note H, the above-mentioned financial statements present fairly the consolidated financial position of Interstate Stores, Inc., and subsidiary companies at January 30, 1972 and January 31, 1971, and the consolidated results of their operations and consolidated changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

S. D. Leidesdorf & Co.
Certified Public Accountants

New York, N.Y.
April 17, 1972